Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
	)	
Federal-State Joint Board on Universal Service Seeks Comment On Certain of the Commission's Rules Relating to High-Cost Universal Service Support	)	

COMMENTS OF
FAIRPOINT COMMUNICATIONS

I. INTRODUCTION AND SUMMARY

FairPoint Communications, Inc. (FairPoint) hereby submits these comments in response to the Federal-State Joint Board on Universal Service's (Joint Board) Public Notice, released August 16, 2004.[1] The Public Notice seeks comment on issues relating to the high-cost universal service support mechanisms for rural carriers and the appropriate rural mechanism to succeed the five-year plan adopted in the Federal Communication Commission's (FCC, Commission) Rural Task Force Order.[2]

FairPoint provides telecommunications services to 244,000 rural access lines in 16 states across the country. FairPoint's operations consist of 26 rural study areas serving customers through a total of 82 rural wire centers. FairPoint's smallest study area consists of 348 access

[1] *Federal-State Joint Board on Universal Service Seeks Comment on Certain of the Commission's Rules Relating to High-Cost Universal Service Support*, CC Docket No. 96-45, Public Notice, FCC 04J-2 (rel. Aug. 16, 2004) (Public Notice).
[2] *Federal-State Joint Board on Universal Service,* CC Docket No. 96-45, Fourteenth Report and Order, Twenty-Second Order on Reconsideration, and Further Notice of Proposed Rulemaking, *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers,* CC Docket No. 00-256, Report and Order, 16 FCC Rcd 11244 (2001) (Rural Task Force Order).

lines served by a single wire center, and its largest study area serves 37,000 access lines through four wire centers.

FairPoint is an active Member of the Organization for the Promotion and Advancement of Small Telephone Companies (OPASTCO), and has participated in the drafting of its comments. To the extent that FairPoint's comments do not address certain issues raised in the Joint Board Notice, FairPoint supports the position advanced in the OPASTCO comments.

The Notice seeks comment in three general areas:

1. Whether a rural universal service support mechanism based on embedded cost or forward-looking economic costs best achieves the goals of the 1996 Act?

2. Whether the definition of rural telephone companies should be changed or modified for the determination of high-cost support, and if other changes in the calculation of rural high-cost support should be implemented. In particular, the Joint Board has asked for comments regarding:
   - Whether the definition of "rural telephone companies" contained in Section 3(37) of the 1996 Act should continue to be used to define companies subject to the "rural" mechanism?
   - Whether different high-cost mechanisms should apply to carriers based upon the number of lines in a study area (i.e., under 50,000 lines, 50,000 lines to 100,000 lines and over 100,000 lines)?
   - Whether all of a company's study areas in a state should be consolidated for support determination purposes?
   - Whether holding company size, as well as study area size, should be considered?
   - How support for competitive ETCs should be determined?

3. Whether the Commission's rules regarding support for transferred exchanges should be retained or modified?

For the reasons that will be more fully stated in the following sections, FairPoint believes that high-cost support for rural carriers must continue to be determined based upon the actual embedded cost of rural carriers' study areas. Any other means of determining support would fail to achieve the important universal service goals and objectives contained in the 1996 Act.

In July of 1998, the Joint Board appointed the Rural Task Force (RTF) to develop a forward-looking proxy model for rural carriers similar to the one that the Commission had previously developed for non-rural carriers. After two years of intensive and fact-based analysis, and the issuance of six detailed white papers, the RTF concluded that it would not be in the public interest to determine high-cost support for rural carriers based on a forward-looking proxy model. As will be discussed in the following sections, nothing has changed that would make a forward-looking proxy model any more acceptable now for determining rural high-cost support needs than it was when the RTF issued its original recommendations.

FairPoint also believes that it would not serve, and indeed would harm, the public interest to subdivide the universe of rural telephone companies for purposes of developing different high-cost support mechanisms. Rural telephone companies exist to serve areas of the nation where costs are higher than in urban areas, and where explicit high-cost support is needed to assure the statutory goal of comparable services offered at comparable prices. These differences were well documented by the RTF in White Paper No. 2. Unlike the RBOCs, companies such as FairPoint that operate in multiple high-cost rural areas do not have large concentrations of low-cost urban customers against which to average their high-cost serving areas. Rural companies such as FairPoint are a small fraction of the size of the RBOCs, and thus have nowhere near their scale and scope economies. Thus forward-looking proxy models that may be appropriate for the RBOCs would be totally inappropriate for larger rural carriers and rural holding companies such as FairPoint. Furthermore, the dispersed nature of rural serving areas does not provide scale and scope efficiencies in the construction and maintenance of loop plant, and rural communities have smaller population clusters, resulting in fewer lines per switch. For this reason it would not be in the public interest to average support among multiple rural study areas in a state.

In order to meet the expressed goals of the 1996 Act, as well as to control recent growth in the size of the fund, support to Competitive Eligible Telecommunications Carriers (CETCs) should be based on each ETCs cost of providing universal service. The current rules that provide CETCs with the same per-line support as the wireline incumbent are irrational and waste scarce public resources since many CETCs, particularly wireless carriers, provide different services, often over different service areas. Basing all ETCs support upon their own reasonable costs is a better way to control the growth and fund size than other alternatives that have been proposed recently, such as limiting support to primary lines.

Finally, FairPoint believes that the Joint Board could help to improve and modernize services to many rural consumers by modifying the Safety Valve mechanism to provide incentives for carriers to invest in acquired rural exchanges. In many parts of the nation, non-rural carriers have failed to adequately invest in their rural infrastructure. By updating the Safety Valve rules, carriers who acquire underserved exchanges will have incentives to invest in modern plant and equipment, and consumers in many parts of rural America will have the prospect of improved access to broadband and other advanced services.

II. BACKGROUND

In the initial universal service order, the Commission expressed a general preference for the determination of high-cost universal service support based upon forward-looking economic cost:

> We agree with the Joint Board's recommendation that the proper measure of cost for determining the level of universal service support is the forward-looking economic cost of constructing and operating the network facilities and functions used to provide the supported services as defined per section 254(c)(1). We agree with the Joint Board and many commenters that, in the long run, forward-looking economic cost best approximates the costs that would be incurred by an efficient carrier in the market. We concur with the Joint Board's finding that the use of forward-looking economic cost as the basis for determining support will send the correct signals for entry, investment and innovation.[3]

[3] *In the Matter of Federal-State Joint Board on Universal Service*, Report and Order, CC Docket 96-45, released May 8, 1997 at paragraph 224.

The Commission proceeded initially with the development of the non-rural forward-looking economic cost model, but concluded that a forward-looking model would be applied to rural carriers "only when we have sufficient validation that forward-looking support mechanisms for rural carriers produce results that are sufficient and predictable."[4] To "assist in identifying the issues unique to rural carriers and analyze the appropriateness of proxy cost models for rural carriers",[5] the Joint Board recommended, and the Commission approved, the creation of a Rural Task Force (RFT). The RTF began its work in July of 1998, and published six White Papers. The RTF issued its final Recommendation to the Joint Board in September of 2000.[6]

As part of its systematic analysis of rural carriers and of rural universal service support mechanisms, the RTF developed and published its landmark White Paper 2.[7] In describing the purpose for this paper, the RTF stated:

> While the "rural difference" is generally recognized, it is largely undocumented. White Paper 2 describes data assembled for the first time on a national basis, systematically comparing and contrasting rural carriers and non-rural carriers. Equally important, the analysis presented here also documents a substantial diversity among rural carriers themselves. An understanding of differences <u>between</u> rural carriers and non-rural carriers, and diversity <u>among</u> rural carriers is key to designing appropriate mechanisms and policies necessary to achieve the universal service principles required by the 1996 act. (emphasis in original)

In summarizing the conclusions of White Paper 2, the RTF Recommendation cited the following major areas of difference between rural and non-rural carriers:

- Rural carriers serve more sparsely populated areas
- There is significant variation in study area sizes and customer bases among rural carriers
- Isolation of areas served by rural carriers results in numerous operational challenges
- Compared with non-rural carriers, the customer base of rural carriers generally included fewer high-volume users, depriving rural carriers of economies of scale

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[4] Id at paragraph 252.
[5] Id at paragraph 253.
[6] *Rural Task Force Recommendation to the Federal-State Joint Board on Universal Service,* CC Docket No. 96-45, released September 29, 2000.
[7] *The Rural Difference*, January, 2000. Copies of this and other RTF white papers can be obtained at the RTF web site - www.wutc.wa.gov/rtf.

- Compared to customers of non-rural carriers, customers of rural carriers tend to have a relatively small local calling scope and make proportionately more toll calls
- Rural carriers frequently have substantially fewer lines per switch than do non-rural carriers, providing fewer customers over which to spread high fixed network costs
- Total investment in plant per loop is substantially higher for rural carriers than for non-rural carriers
- Plant-specific and operations expenses for rural carriers tend to be substantially higher than for non-rural carriers
- Customers served by rural carriers have different demographic characteristics from customers in areas served by non-rural carriers.

Before any significant changes are made in the policy framework developed by the RTF, it will be necessary to identify and document any changes in the underlying data and assumptions upon which that framework was based. Since virtually all of the factors identified in White Paper 2 are related to either the demographic or topographic characteristics of rural America, it is unlikely that any of the major conclusions regarding the different situations faced by rural carriers have changes significantly since the paper was published in January of 2000.

One of the major policy recommendations of the RTF was that "the Synthesis Model not be used for determining the forward-looking costs of rural carriers."[8] Instead, the RTF recommended that "the Modified Embedded Cost Mechanism of federal universal service support for rural carriers be adopted for sizing the rural carrier universal service fund."[9] The RTF recommended that this method of determining high-cost support requirements remain in place for at least five years.[10]

The RTF made its recommendation to not adopt the Synthesis Model, which had previously been approved for use by non-rural carriers, based upon a rigorous study that is

[8] RTF Recommendation at page 4.
[9] Id.
[10] Id at page 3.

documented in White Paper 4.[11] In summarizing its conclusions reached from White Paper 4, the RTF stated:

> The aggregate results of this study suggest that, when viewed on an individual wire center or individual rural carrier basis, the costs generated by the Synthesis Model are likely to vary widely from reasonable estimates of forward-looking costs. As a result, it is the opinion of the Task Force that the current model is not an appropriate tool for determining forward-looking cost of rural carriers.[12]

The RTF's decision to recommend that the Synthesis Model was not suitable for the determination of support requirements of rural carriers was based upon additional differences that the Task Force identified between rural and non-rural carriers, and the role that high-cost support plays in its ability to deliver service to consumers:

> Two additional differences between rural carriers and non-rural carriers contribute to the Task Force's conclusion that the non-rural method is not sufficiently accurate to form the basis for determining each rural carrier's explicit support:
> - Most non rural carriers, particularly the RBOCs, serve hundreds or thousands of wire centers, while most rural carriers serve relatively few wire centers, and
> - Current explicit support is a tiny fraction of the non-rural carrier's revenue requirements, while for many, or most, rural carrier it constitutes a critical share of their revenue requirements.[13]

The RTF goes on to note that:

> The "Law of Large Numbers" suggests that for the RBOCs, those wire centers where the support results are too high will tend to offset those which are too low, resulting in a reasonable overall result. This is not the case for many rural carriers who serve only a few wire centers, or in some cases a single wire center. The financial impact of any error in support calculation is also minimal for the RBOCs. These companies today receive approximately $400 million in explicit universal service support, but have overall loop revenue requirements of approximately $40 billion. Thus, high-cost funding for non-rural carriers represents approximately one percent of loop revenue requirements. In contrast, within the group of 1,300 rural carriers federal universal service support payments for high-cost loop support range from zero percent to as high as 74 percent of loop revenue requirements. Thus, the result of errors or radical changes in the amount of support developed from a model that is imprecise at the company level could cause an

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[11] *A review of the FCC's Non-Rural Universal Service Fund Method and the Synthesis Model for Rural Telephone Companies*, September, 2000.
[12] RTF Recommendation at page 18.
[13] White Paper 4 at page 7.

> individual rural carrier to either gain a substantial windfall or have a serious deficiency in "sufficient" support.[14]

Thus, the RTF concluded that it was the combination of the imprecision of the model at the individual wire center level, coupled with fact that rural carriers had a much more significant portion of their revenues dependent upon explicit high-cost support mechanisms that made the proxy model inappropriate for use with rural carriers.

Since the release of the RTF recommendation, there have been additional concerns and issues related to the use of forward-looking proxy models. Specifically, the Commission also utilized forward-looking cost principles and models as the basis for the pricing of unbundled local loops and other network elements.[15] A forward-looking proxy model develops an estimate of costs for a hypothetical and hyper-efficient single provider of service using the most current and efficient technology in a single and instantaneous build-out. As the stated in the Local Competition Order, the Commission's belief was that the use of forward-looking economic cost would "encourage efficient levels of investment and entry."[16] Unfortunately, things haven't worked out quite the way it was hoped that they would. Rather than spur investment in telecommunications infrastructure, the pricing of unbundled network elements at forward-looking economic cost contributed, in part, to a dramatic decline in telecom investment, the loss of hundreds of thousands of jobs and trillions of dollars in market capitalization. Remarking on the state of the industry at a conference in late 2002, Chairman Michael Powell stated:

> We are ready to accept almost any explanation for the crisis … except one: that the present state of the world may be the result of genuine error on our part and that the

[14] White Paper 4 at pages 7 to 8.
[15] Indeed, much of the model work undertaken during the Commission's proxy model proceeding, circa 1997, found its way into the TELRIC models now in use to establish Unbundled Network Element (UNE) prices.
[16] *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, CC Docket No. 96-98, First Report and Order, 11 FCC Rcd 16499 (1996) at paragraph 672.

> pursuit of some of our most cherished ideals has apparently produced results utterly different from those which we expected.[17]

In September of 2003, the FCC issued a Notice of Proposed Rulemaking seeking input on its forward-looking economic cost (TELRIC) methodology, and acknowledging that its prior views regarding the determination of forward-looking economic costs methodologies may not be producing the desired results. In this Notice, the FCC makes the following statements:

- To the extent that the application of our TELRIC pricing rules distorts our intended pricing signals by understating forward-looking costs, it can thwart one of the central purposes of the Act: the promotion of facilities-bases competition.[18]
- We tentatively conclude that our TELRIC rules should more closely account for the real-world attributes of the routing and topography of an incumbent's network in the development of forward-looking costs.[19]
- The UNE pricing methodology, while forward-looking, must be representative of the real world and should not be based on the totally hypothetical cost of a most-efficient provider building a network from scratch.[20]
- We ask parties to discuss whether a regime focused more closely on the existing network of an incumbent LEC would be easier for state commissions to implement than the current TELRIC regime.[21]

All of the problems identified by the Commission in the TELRIC Notice are currently present in the Commission's forward-looking Synthesis Model.

III. EMBEDDED vs. FORWARD-LOOKING ECONOMIC COST

One of the most significant questions raised by the Commission in this Notice is "whether a rural support mechanism that bases support on forward-looking economic costs or on embedded costs more efficiently and effectively achieves the Act's goals?"[22] In order to answer this question it is necessary to look first to the universal service goals of the 1996 Act, and how the use of actual embedded costs or forward-looking proxy costs would impact the achievement

[17] Remarks of Chairman Michael Powell at the Goldman Sachs Communicopia XI conference, October 2, 2002.
[18] Notice of Proposed Rulemaking, WC Docket No. 03-173, Released September 15, 2003 at paragraph 3.
[19] Id at paragraph 52.
[20] Id at paragraph 53.
[21] Id at paragraph 60.
[22] Notice at paragraph 21

of these goals. It is also necessary to look at the forward-looking economic cost model process and determine whether it has, or can, overcome the deficiencies identified by the RTF, and whether a forward-looking model can achieve the accuracy and precision necessary for the determination of high-cost support for rural telephone company service areas.

A. Embedded Costs Will Better Achieve the Goals of the 1996 Act

For purposes of determining the appropriate basis for computation of high-cost support for rural telephone companies, it is helpful to look at three of the specific universal service goals as stated in the Act:

254(b)(5) SPECIFIC AND PREDICTABLE SUPPORT MECHANISMS
There should be specific, predictable and sufficient Federal and State mechanisms to preserve and advance universal service

254(b)(3) ACCESS IN RURAL AND HIGH-COST AREAS
Consumers in all regions of the Nation, including low-income consumers and those in rural, insular and high-cost areas, should have access to telecommunications and information services, including interexchange services and advanced telecommunications and information services, that are reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas.

254(b)(2) ACCESS TO ADVANCED SERVICES
Access to advanced telecommunications and information services should be provided in all regions of the nation.

Section 254(b)(5) states that universal service must be "specific". It is difficult to see how a proxy model based upon an assumption of a hypothetical new market entrant can be called "specific" to a particular rural carrier. This is particularly true given the significant differences identified by the RTF in White Paper 2. Embedded costs are taken from the actual books of account of each rural carrier and are thus much more "specific". Section 254(b)(5) also says that support must be "predictable". In White Paper 4, the RTF cites the following conclusions reached following its detailed and rigorous examination of the Synthesis Model results for 218 rural telephone companies:

- The model lines differ significantly from actual lines served. While the model generally tends to underestimate lines, in about one-third of the wire centers it overestimated lines.
- Comparisons of the number of route-miles of plant summarized in the model with actual data produced significant variations. Again, differences occur on both the high and low ends with a general tendency for the model results to overestimate the actual data. In 12 percent of the wire centers studied the model data overestimated route miles by more than 200 percent.
- Model results for the type of plant vary widely from actual plant constructed. The model generally tends to overestimate the percentage of aerial and underground plant, and underestimate the percentage of buried plant. This is likely due to the diverse character of the rural geography, and the use of a single set of inputs by density zone based on the experience of non-Rural Carriers.
- In calculating the applicable density zones, the model significantly underestimates wire center area. In 95 percent of wire centers the land area is understated, and in over one third of these the understatement exceeds 90 percent.
- It significantly underestimates COE Switching investment. This is likely due to the lack of economies of scale of the Rural Carriers, and the general tendency of the model to underestimate lines served.
- Model results for various elements of general support investment vary widely from actual data and from rational forward-looking assumptions, with almost as many cases of overestimation as underestimation.
- Network Operations and Corporate Operations expenses are significantly underestimated, again likely due to the lack of economies of scale of Rural Carriers.[23]

These factual findings clearly underscore the fact that unless major steps are taken to correct these observed problems with the Synthesis Model, the model cannot be deemed to be "predictable". Embedded costs, taken from the company's actual books of account would appear to be much more "predictable".

The final requirement of 254(b)(5) is that funding be "sufficient". In order for the forward-looking model to determine a sufficient amount of high-cost support, it would need to be able to accurately and predictably approximate the cost of building and supporting the

[23] White Paper 4 at pages 9 to 10.

network in each particular rural area. The shortcomings of the forward-looking economic cost assumptions identified in the Commission's TELRIC Notice indicate that the current forward-looking cost assumptions may have a bias towards underestimating costs. If this is the case, then substantial modifications would need to be made to the Synthesis Model for it to be determined to be "sufficient". Embedded costs are, by definition, "sufficient" to cover the costs of serving the rural area in question.

Section 254(b)(3) requires that consumers in all parts of the nation have access to services, including advanced services, and prices that are reasonably comparable to those in urban areas. The ability for rural companies to fulfill this obligation ties directly to support mechanisms that are "specific, predictable and sufficient". As discussed above, support based upon actual embedded cost accomplishes this better than forward-looking cost models.

Finally, Section 254(b)(2) requires that "access to advanced telecommunications and information services should be provided in all regions of the nation." In its recommendation, the RTF states the following:

> In recommending that support for rural carriers be based on embedded costs, the Task Force is recommending a support mechanism that inherently provides incentives for the infrastructure investments necessary for providing access to advanced services. … The federal universal service support fund should be sized so that it presents no barriers to investment in plant needed to provide access to advanced services. Specifically, to remain "sufficient" under the 1996 Act, the fund should be sized so that investment in rural infrastructure will be permitted to grow.[24]

The RTF recommended a "no barriers to advanced services" policy that focuses on creating investment incentives to allow rural carriers to provide access to broadband and advanced services to rural consumers.

As noted previously, forward-looking economic cost models have exhibited documented tendencies to discourage, rather than encourage, investment in infrastructure. Unless and until

[24] RTF Recommendation at pages 22 to 23.

these fundamental flaws in the forward-looking economic cost models are fixed, rural support mechanisms based upon embedded cost provide the most certain methodology to assure that the goals of the 1996 Act are achieved. The use of embedded costs carries an additional advantage in terms of incentives to invest in telecommunications infrastructure. In any business or market, and particularly in today's uncertain telecom markets, private capital will only be invested if there is a reasonable expectation of earning a return on that investment. Rural support mechanisms based on embedded cost provide a greater certainty of that return, and thus carry a greater likelihood that rural consumers will benefit from access to advanced services.

B. It Will be Difficult, if Not Impossible, to "Fix" the Synthesis Model

It is significant to note, that since the Synthesis Model was first adopted by the Commission,[25] FairPoint is aware of nothing has been done or proposed that would address the fundamental flaws inherent in using the Synthesis Model as the basis for the determination of the "sufficient" level of support for individual rural carriers. The Synthesis Model was designed for and found to be appropriate for use with non-rural carriers. One of the key factors that must be considered in evaluating a forward-looking proxy model for rural carriers is "precision". As discussed previously, the RTF found that because non-rural carriers had "hundreds or thousands" of wire centers, it was less important that the model be precise at the level of a single wire center. Furthermore, since universal service support provides "a tiny fraction" of the revenue requirements of non-rural carriers, model precision is much less important than for rural carriers where it "constitutes a critical share of their revenue requirements.

Thus, in order for the Synthesis Model (or any proxy model) to become more acceptable for the determination of rural company support, it would have to achieve a significantly greater

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[25] *In the Matter of Federal-State Joint Board on Universal Service, Forward-Looking Mechanism for High Cost Support for Non-Rural LECs*, CC Docket Nos. 96-45 and 97-160, Tenth Report and Order, Released November 2, 1999.

level of precision in the estimation of individual rural company cost. There are two very real problems that make it unlikely that this can be accomplished. First is the reality that in proxy modeling applications such as the Synthesis Model, increased levels of precision come only at the expense of geometrically increasing levels of model cost. Second, the current state-of-the-art, represented by the Synthesis Model, was the result of an intensive research and development process by two competing model proponents over several years.

The BCPM Model was jointly developed by BellSouth, Sprint and U S WEST. The HAI model was jointly developed by AT&T and MCI. While exact figures are unknown, it is likely that both parties expended many millions of dollars in their individual developmental efforts. In addition, the Commission staff spent many months conducting workshops among interested parties to understand and refine the two models, and ultimately develop the Synthesis Model. Given the reality of telecom markets and players today, it is questionable that the resources exist to even duplicate the original proxy development effort, let alone take the model to the increasing levels of precision that would be necessary to serve as the basis for determining individual rural company support. On top of these complexities, it must also be remembered that the fundamental issue of the relationship between the assumptions inherent in the development of forward-looking economic costs and incentives to invest in telecommunications infrastructure identified in the TELRIC Notice still remain to be solved.

C. Use of Forward-Looking Economic Cost is Inappropriate for a Rural Company Such as FairPoint Communications.

While FairPoint is a holding company serving 244,000 access lines nationwide, it is in reality a collection of 26 rural study areas, with cost and operating characteristics similar to the overall body of rural telephone companies. It is radically different from the universe of non-rural telephone companies and RBOCs. The following table provides a comparison of non-rural, rural, and FairPoint study areas.

	Study Area Lines	Per-Line Support
All Non-Rural		
Average	1,293,002	$0.72
Median	736,265	$0.73
All Rural		
Average	17,541	$8.52
Median	3,222	$19.07
FairPoint		
Average	**8,535**	**$18.40**
Median	**4,447**	**$20.00**

Notice that while the average non-rural study area has approximately 1.3 million lines, the average FairPoint study area serves only 8,535 lines, over 150 times smaller. The average non-rural study area receives less than one dollar per line per month in high-cost support, while the average FairPoint study area receives over $18 per line per month. Compared on both an average and median[26] basis, FairPoint compares favorably with other rural study areas. The average FairPoint support per line is over twice the average for all rural study areas, and the median FairPoint per-line support is also higher than the median for all rural study areas.

For all of these reasons, FairPoint, like all other rural study areas, should continue to have its high-cost support determined based upon embedded cost.

IV. THE CURRENT DEFINITION OF A RURAL CARRIER SHOULD NOT BE CHANGED FOR UNIVERSAL SERVICE DETERMINATION PURPOSES

In the Notice, the Joint Board asks a number of questions about whether the universe of rural telephone companies and study areas should be further subdivided for the determination of

[26] The median represent the point at which half of the study areas would be above this level, and half below.

universal service support or the method by which support should be determined. Among other things, the Joint Board asks:

- Should different mechanisms be developed to determine support for small (less than 50,000 lines), medium (50,000 to 100,000 lines) and large (over 100,000 lines) rural study areas? (paragraphs 11 and 14)
- Should holding company size as well as study area size be considered in determining high-cost support? (paragraph 13)
- Whether the demographics of the territory served, such as the density of customer locations, should be used to determine whether support should be computed on a forward-looking or embedded basis. (paragraph 25)

In asking these questions, the Joint Board either states or implies that some carriers enjoy greater or lesser economies of scale than others, and that some areas are less costly to serve than others. One of the principal advantages of using actual embedded cost to determine support, however, is that it automatically takes all of these factors into account. Areas that are less costly to serve will receive less support, and those that are more costly to serve will receive more support. To the extent that a holding company structure provides scale economies, those will be reflected in the underlying cost structure of its study areas. The alternative – designing different support mechanisms or cost models for different carriers – is not only unnecessary, but it would add significantly and unnecessarily to the cost and complexity of administering the high-cost universal service support system.

V. THE PUBLIC INTEREST WOULD BE HARMED BY ARBITRARILY COMBINING RURAL STUDY AREAS WITHIN A STATE

Section 254(e) requires that universal service support be "explicit". Whenever costs are averaged over larger service areas it has the effect of having consumers in the lower cost areas subsidize customers in the higher cost areas. Combining existing study areas within a given state for support determination purposes implicitly assumes that scale economies in the provision of service will result from such a combination. This is usually not the case, as the rural service areas are often separated by long distances. More importantly, the higher costs of installing and maintaining loop plant in one sparsely populated area is not materially affected by the provision of loop plant in a different sparsely populated service area located a hundred miles or more away. Similarly, the higher costs of operating a switch with a small number of lines in one rural community is totally unaffected by the fact that the same company may operate another switch serving a small number of access lines in a distant community.

FairPoint's service area provides a good example of why this is so. Attachment A is a map of the state of Colorado showing the location of FairPoint's three study areas in this state. The map is also color-coded to show the various density zones utilized in the Commission's Synthesis Model. FairPoint has three study areas in Colorado – Big Sandy Telecom, Columbine Telecom and Sunflower Tel. Co.. As can be clearly seen, these study areas are located in very low-density parts of the state, and are located over 100 miles from each other. The following table shows the number of lines[27] in each study area, the area of the study area in square miles, the average density of the study area in lines per square mile, and the monthly per-line support provided in the study area.

FairPoint Colorado Study Areas				
Study Area	**Lines**	**Area (sq mi)**	**Density (Lines/sq mi)**	**Monthly Support**
Big Sandy	1,128	604	1.9	$38.01
Columbine	1,517	1,372	1.1	$63.03
Sunflower	348	917	0.4	$99.87

The fact that these study areas are located so distant from each other limits the possibility of sharing personnel and equipment among these service territories..

[27] While this table shows lines, the density color coding is stated in terms of households per square mile.

Attachment B provides a map depicting FairPoint's four study areas in the state of Illinois. The following table provides data regarding these study areas.

FairPoint Illinois Study Areas				
Study Area	Lines	Area (sq mi)	Density (Lines/sq mi)	Monthly Support
C - R	979	139	7.0	$45.24
El Paso	2,149	90	23.9	$11.75
Odin	1,152	285	4.0	$46.66
Yates City	560	47	11.9	$29.09

As can be seen, similar to the Colorado study areas, the non-contiguous nature of FairPoint's rural study areas in Illinois precludes any major operating efficiency, and therefore averaging these study areas together for purposes of determining "sufficient" high-cost" support would serve no valid public interest purpose.

VI. SUPPORT FOR CETCs SHOULD BE BASED UPON THE CETCs ACTUAL COSTS FOR PROVIDING UNIVERSAL SERVICE

One of the reasons for the recent dramatic growth in the high-cost fund is that increasing numbers of wireless ETCs are being approved, and they are being provided funding based not upon their own costs, but rather based upon the existing per-line support level of the wireline incumbent. The more stringent and uniform ETC designation standards adopted by the Commission in the *Virginia Cellular*[28] and *Highland Cellula*[29]*r* decisions, and recommended by the Joint Board in its Recommended Decision[30], should help to slow the rapid growth in the number of wireless ETCs. A more fundamental problem, however is that once designated as an

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[28] In the Matter of Federal-State Joint Board on Universal Service, CC Docket No. 96-45, *Memorandum Opinion and Order*, FCC 03-338 (rel. January 22, 2004).
[29] In the Matter of Federal-State Joint Board on Universal Service, CC Docket No. 96-45, *Memorandum Opinion and Order*, FCC 04-37 (rel. April 12, 2004).
[30] Federal-State Joint Board on Universal Service, CC Docket 96-45, Recommended Decision (re. Februrary 27, 2004).

ETC, the wireless carrier receives the same per-line support as the wireline incumbent despite the fact that wireless and wireline technologies have fundamentally different cost drivers, and that wireless and wireline providers have different service obligations. For example, wireline carriers are required to provide equal access to operator service, are required to stand ready to serve as Carriers of Last Resort, and are held by state regulators to stringent service quality standards. Furthermore, wireless carriers are often granted ETC status for an area smaller than the ILEC's entire study area. For all of these reasons, FairPoint believes that the public interest would be best served by providing wireless ETCs with support based upon their own cost of providing universal service.

VII. THE RULES FOR SUPPORTING NEW INVESTMENT IN ACQUIRED EXCHANGES SHOULD BE MODIFIED

Under part 54.305 of the Commission's rules, carriers acquiring exchanges receive the same support that the seller of the exchange previously received. Under the Commission's current non-rural support mechanism, and based upon the Synthesis Model and the statewide averaging of cost in the non-rural mechanism, many non-rural exchanges in otherwise high-cost rural areas receive little or no high-cost support. Due, in part, to this lack of explicit support, investment in many rural areas served by non-rural carriers has lagged behind that of urban areas, and consumers in these areas suffer from outdated plant and equipment, and a lack of access to advanced service capabilities.

Under the Safety Valve mechanism, carriers that make investment in upgrading plant and equipment in such exchanges may qualify for Safety Valve support to cover a portion of the cost of upgrading facilities in the acquired exchanges. Under the current 54.305 rules, however, the Safety Valve mechanism suffers from three fundamental problems. First, a carrier must wait at least one year after the acquisition is made to make investment that would qualify for high cost support. Second, support is only provided for 50% of the cost of the upgraded investment. Finally, the total amount of Safety Valve support for the entire nation is limited to no more than 5% of the total High Cost Loop fund.

If these rules were modified, companies such as FairPoint would have increased incentives to acquire and upgrade currently underserved rural properties. FairPoint would suggest three modifications to these rules. First, the one-year waiting period to begin investment should be eliminated. Consumers want improved service now. Second, carriers willing to invest in underserved rural areas should receive high cost support based upon all of their new investment, not just 50%. Finally, the 5% cap on the Safety Valve Mechanism should be eliminated. In the fourth quarter of 2004, the High-Cost Loop mechanism totaled $1.25 billion[31]. Thus, under the cap the Safety Valve mechanism is limited to $62.5 million, a small fraction of what will be required to upgrade the many parts of rural America that are currently underserved. Policy makers seeking to improve rural consumers' access to broadband and other advanced services should utilize the updating of the Safety Valve rules as an tool to help achieve these important goals.

VIII. CONCLUSION

For all of the reasons described above, FairPoint recommends that the Joint Board:

- Continue to base its rural high-cost support mechanism on embedded cost;
- Apply the rural high cost support mechanism to "rural telephone companies" as defined in Section 3(37) of the 1996 Act;
- Determine support for competitive ETCs based upon their own cost; and

[31] USAC report HC01, fourth quarter 1004.

- Revise the rules for the provision of acquired exchanges to provide incentives for companies to invest to better serve rural consumers.

Respectfully submitted,

FAIRPOINT COMMUNICATIONS

(via electronic filing) .

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